

**LEGISLATIVE SERVICES AGENCY  
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**FISCAL IMPACT STATEMENT**

**LS 6498**  
**BILL NUMBER:** HB 1600

**NOTE PREPARED:** Dec 27, 2002  
**BILL AMENDED:**

**SUBJECT:** Military Pay.

**FIRST AUTHOR:** Rep. Reske  
**FIRST SPONSOR:**

**BILL STATUS:** As Introduced

**FUNDS AFFECTED:** ☒ **GENERAL**  
☒ **DEDICATED**  
**FEDERAL**

**IMPACT:** State & Local

**Summary of Legislation:** The bill exempts adjusted gross income, including retirement or survivor's benefits, derived from service in the armed forces, including a reserve component, from state Adjusted Gross Income (AGI) Taxation. The bill also repeals a partial deduction for income derived from military service.

**Effective Date:** January 1, 2003 (retroactive).

**Explanation of State Expenditures:** The Department of State Revenue (DOR) would incur some administrative expenses relating to the revision of tax forms, instructions, and computer programs to incorporate this exemption. These expenses presumably could be absorbed given the DOR's existing budget and resources.

**Explanation of State Revenues:** The bill would reduce state Adjusted Gross Income (AGI) Tax liabilities of individual taxpayers who are active duty or reserve military personnel, or who receive military retirement benefits. The revenue loss due to this bill could potentially total \$14.9 M in FY 2004 and \$15.0 M in FY 2005. The revenue loss is expected to increase thereafter by about 0.6% annually.

*Background:* The bill eliminates the existing AGI Tax deduction for the first \$2,000 in military service income (including military retirement and survivor's benefits) received during a taxable year and, instead, fully exempts military service income from the AGI Tax. Data from the Department of State Revenue indicates that 34,476 taxpayers claimed the military service deduction in tax year 2000. These taxpayers deducted approximately \$67.6 M in adjusted gross income. This resulted in a revenue loss of about \$2.3 M in FY 2001.

The fiscal impact is based on DOR tax data and census and pay rate data for military retirees and active duty and reserve personnel in Indiana reported by the Department of Defense (DOD). Imputed totals for 2001 and 2002 based on the DOD census and pay rate data and actual totals for the military service deduction through 2000 suggest that the retirement portion of this deduction is increasing slightly by 0.84% annually. The imputed totals also suggest that the active duty/reserve pay component is declining by 0.4% annually. Based on this information, the military service deduction is expected to increase slightly by about 0.6% annually. Since the bill is effective beginning in tax year 2003, the fiscal impact would begin in FY 2004. It is estimated that military service income in excess of that currently deductible could potentially total about \$437.4 M in 2003, and increase to about \$439.8 M in 2004, provided the slight trends in the imputed deduction amounts occur. Thus, fully exempting military service income is estimated to reduce AGI Tax revenue by \$14.9 M in FY 2004 and \$15.0 M in FY 2005.

Some military retirement income (i.e., disability retirement income) is currently not taxable under the federal Income Tax and, as a result, is already excluded from Indiana AGI. Recent DOD retirement pay data does not delineate between taxable and tax exempt military retirement payments to Indiana retirees. However, the proportion that is tax exempt is not expected to exceed 10% of total retirement payments. Thus, the revenue loss from the bill could be somewhat lower to the extent that DOD's military retirement payments to Indiana retirees reflect federally tax exempt retirement income. Eighty-six percent of the revenue from the AGI Tax on individuals is deposited in the state General Fund, and 14% of this revenue is deposited in the Property Tax Replacement Fund.

**Explanation of Local Expenditures:**

**Explanation of Local Revenues:** Because the proposed exemption for military service income (including retirement and survivor's benefits) would serve to decrease taxable income, counties imposing local option income taxes (CAGIT, COIT, and/or CEDIT) may, as a result, experience an indeterminable decrease in revenue from these taxes.

**State Agencies Affected:** Department of State Revenue.

**Local Agencies Affected:** Counties with a local option income tax.

**Information Sources:** Department of State Revenue Income Tax data; Mike Dove, Department of Defense, Manpower Data Center, (831) 583-2400.

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